Decision 06-06-036 June 15, 2006

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SAN GABRIEL VALLEY WATER COMPANY (U337W) for Authority to Increase Rates Charged for Water Service in its Fontana Water Company Division to Increase Revenues by $11,573,200 or 39.1% in 2003, $3,078,400 or 7.3% in 2004, $3,078,400 or 6.8% in 2005, and $3,079,900 or 6.4% in 2006.	Application 02-11-044 (Filed November 25, 2002; Rehearing Granted August 25, 2005)

OPINION ON LIMITED REHEARING OF DECISION 04-07-034

Summary

In Decision (D.) 04-07-034, San Gabriel Valley Water Company (San Gabriel) was granted a rate increase for its Fontana Water Company Division of $10.5 million over three years. In D.05-08-041, we granted limited rehearing based on the existing record to determine if San Gabriel had met its burden of proof to support the rate increase. This decision affirms D.04-07-034. Like D.04-07-034 it finds that, with certain exceptions, San Gabriel met its burden of proof regarding the rate increase and that San Gabriel's proposed construction projects, including any changes or substitutions, are needed, reasonable, and justified; that there is evidence of record supporting the finding that $2.6 million in proceeds were invested in the F-10 Plant; and that there are special circumstances warranting San Gabriel's deviation from Standard Practice (SP) U-16, concerning working cash.

This decision also finds that San Gabriel did not meet its burden of proof on certain ratemaking issues, specifically: (A) gains from (1) sales of real estate,

(2) water contamination lawsuits and settlements, (3) condemnations, and (4) inverse condemnations; (B) contributions in aid of construction; and (C) the purchase price of land for a new office. As to those issues, this rehearing decision orders that the rates and charges authorized by D.04-07-034 are subject to refund. To the extent that financial gains were not the property of San Gabriel (and should have been allocated to ratepayers), but were invested in plant, those gains should be treated as contributions in aid of construction.

The amount of any refunds and reductions to rate base will be determined in San Gabriel's current rate case, Application 05-08-021.

Background

In D.04-07-034, San Gabriel was granted a rate increase for its Fontana Water Company Division of $7,157,700 (or 22.4%) for test year 2004; $1,674,400 (or 4.3%) for attrition year 2005; and $1,675,000 (or 4.1%) for attrition year 2006. The most controversial issue was the disposition of funds received by San Gabriel since 1996 from sales of property, condemnation awards, and water contamination lawsuits and settlements. (See D.04-07-034, *mimeo.*, pp. 42-49.) As a result of that controversy, we directed the Commission's Water Division to perform an audit and we ordered that revenue related to those proceeds was subject to refund. (*Mimeo.*, pp. 70-71, Ordering Paragraph 8.)

The pertinent findings, conclusions of law, and ordering paragraphs in D.04-07-034 are:

Findings of Fact (*Mimeo.*, p. 66.)

16. The record does not support DRA's proposed $15.1 million adjustment for condemnation proceeds received by San Gabriel.
17. The record in this proceeding is not sufficient to decide the ratemaking treatment of Plant Sales and Condemnation proceeds at issue.

Conclusions of Law (*Mimeo.*, p. 68.)

6. In its next Notice of Intent (NOI) filing, San Gabriel should address the ratemaking treatment of all sale and condemnation proceeds received from 1996 onwards.

8. The ratemaking treatment of the remaining $6.0 million San Gabriel received from the County as compensation for damages to its water rights, along with other sale and condemnation proceeds San Gabriel received from 1996 onwards, should be deferred to the next General Rate Case (GRC) proceeding.

Ordering Paragraphs (*Mimeo.*, pp. 70-72.)

8. San Gabriel, in its next NOI filing for Fontana Water Company Division (Fontana Division), shall fully address all sale and condemnation proceeds received from 1996 onwards with supporting justification for the proposed ratemaking treatment. Since the Commission addresses the usefulness of property and gain on sale on a case by case basis, San Gabriel shall address each individual transaction separately. The revenue related to sale and condemnation proceeds shall be subject to refund pending the Commission's decision in the next general rate case proceeding.

9. The motion of the City of Fontana for an audit of sale and condemnation proceeds is granted. Prior to the next NOI filing, the Commission's Water Division shall audit all sale and condemnation proceeds received by San Gabriel from 1996 onwards.

17. The Commission's Water Division shall audit all sale and condemnation proceeds received by San Gabriel from 1996 onwards.

The City of Fontana (City), Fontana Unified School District (District), and the Commission's Division of Ratepayer Advocates (DRA) timely applied for rehearing of D.04-07-034. In D.05-08-041, we granted limited rehearing. The applicable ordering paragraphs are:

2. The limited rehearing herein ordered shall concern: (a) whether San Gabriel has met its burden of proof regarding its request for

a rate increase and, if not, whether there are special circumstances warranting an exception in this case; (b) whether San Gabriel's proposed construction projects, including any changes or substitutions, are needed, reasonable and justified; (c) whether there is evidence of record supporting the finding that $2.6 million in proceeds received from the County of San Bernardino were invested in the F-10 Plant and whether proceeds invested in Plant F-10 should also be subject to the audit ordered by D.04-07-034 in order to determine precisely what amount were [sic] invested in the F-10 Plant and should be removed from ratebase, and (d) whether there are special circumstances warranting San Gabriel's deviation from SP U-16, concerning working cash.

3. The limited rehearing ordered herein shall be consolidated with San Gabriel's next General Rate Case for its Fontana Division, scheduled to be filed in July 2005.

4. Pending the outcome of the rehearing San Gabriel may continue to bill and collect the rates ordered in D.04-07-034 subject to adjustment. The rates shall be placed in a memorandum account subject to tracking. (D.05-08-041, *Mimeo.*, p. 14.)

At the prehearing conference held on September 29, 2005, it was agreed by all active parties that the rehearing would be limited to a review of the record in A.02-11-044. This was confirmed in the scoping memo of the Assigned Commissioner dated October 20, 2005; "All issues [ordered in D.05-08-041], will be decided on the existing record in A.02-11-044 and briefs to be filed by the parties." (Memo, p. 2.) Those briefs have been received and the rehearing is submitted.[1]

[1] The arguments of DRA, the City, and the District were essentially the same, so in the interest of brevity we do not discuss all points of all parties.

1. **Has San Gabriel met its burden of proof regarding its request for a rate increase and, if not, are there special circumstances warranting an exception in this case?**

Over 70 distinct issues were decided in D.04-07-034. On review, we find that San Gabriel has met its burden of proof on all issues except for the ratemaking treatment of: (1) gains from real property sales, water contamination, condemnations, and inverse condemnations; (2) contributions in aid of construction (CIAC); and (3) the purchase of land for a new office. To the extent that financial gains were not the property of San Gabriel (and should have been allocated to ratepayers), but were invested in plant, those gains should be treated as CIAC. Investments treated as CIAC are removed from rate base, thereby reducing the revenue requirement and the proportional rate increase.

DRA argues that the presiding Administrative Law Judge (ALJ) at the original hearing of A.02-11-044 (ALJ Patrick) did not properly apply the correct standard regarding burden of proof: the applicant must justify its request by clear and convincing evidence. DRA says: "it is clear that ALJ Patrick's proposed decision did not hold the company to that standard, granting all of the company's requests without sufficient analysis or discussion. The Commission then adopted the flawed PD with only minor changes." (DRA Opening Brief (OB), p. 5.)

DRA has misconstrued the burden of proof portion of our decision granting limited rehearing. First, we are not reviewing ALJ Patrick's proposed decision; we are reviewing Commission Decision 04-07-034. This distinction is particularly important when re-evaluating the cost of capital finding in D.04-07-034 where we decided that the return on equity (ROE) should be 10.10% for the test year 2003 and the attrition years 2004 and 2005. After pointing out that San Gabriel requested a ROE of 12.25%, which the Commission found to be

"higher than warranted," DRA says: "Illogically, D.04-07-034 goes on to state: 'On balance, we conclude that an ROE at the upper end of DRA's range of 8.61% -- 10.24% is reasonable and appropriately recognize the business risk facing San Gabriel.' Here, it appears that ALJ Patrick granted higher rates of return despite the finding that SG had not met its burden of proof to show that it faced higher business risks that justified a higher rate of return on capital. Properly applying the burden of proof would result in a finding that the company did not justify higher rates of return by 'clear and convincing evidence' and thus its request should have been denied." (DRA O.B., p.9.)

We agree with DRA that San Gabriel did not sustain its burden of proof regarding a 12.25% ROE – and we did not authorize it. Rather, we adopted a ROE (10.10%) within the range recommended by DRA. Not only is 10.10% well within DRA's range but it is also well below the 11.10% return found reasonable in San Gabriel's Fontana Division's last rate case D.95-06-017, for 1995-1998. (Exh. 17, p. 3.) We take official notice that in San Gabriel's recent Los Angeles Division rate case we adopted a ROE of 10.10% (D.05-07-044), a return stipulated to by DRA.

ROE is the rate case issue most subjective and least susceptible to direct measurement. The Commission exercises expert judgment to assess a reasonable ROE. Arriving at the same recommendation as the presiding ALJ does not mean that we have adopted it without independent reflection. In this instance there is ample clear and convincing evidence that a 10.10% return is reasonable and justified.

Regarding proceeds from certain sales, contamination lawsuits, and condemnations, we find that San Gabriel did not sustain its burden of proof. D.04-07-034 described San Gabriel's position: that all the property sales,

contamination, and condemnation proceeds at issue are subject to Pub. Util. Code § 790[2] because at the time of sale, contamination, condemnation, or involuntary conversion, the properties were no longer necessary or useful in the performance of its obligations as a public utility. San Gabriel received $27,811,312 during the years 1996 to 2004 from proceeds resulting from water contamination settlements, service duplication settlements, condemnation and inverse condemnation proceedings, and real property sales to private property owners. Of the $27.8 million, approximately $13.9 million was allocated to the Fontana Division.

San Gabriel claims that all $27.8 million was invested in plant pursuant to § 790. DRA attempted to remove the $13.9 million from rate base by a working cash reduction. In D.04-07-034 we rejected that attempt (which we reaffirm below) stating "much of the confusion on this issue, as evident from the record, was due to DRA's characterization of this issue as a Working Cash issue, which it is not, and DRA's claim that there are 'missing or unaccounted proceeds.'" (D.04-07-034, *mimeo.*, p. 45.) In D.04-07-034 we put the entire matter over to San Gabriel's next GRC for its Fontana Division, A.05-08-021. We did, however, make a reduction in rate base for a portion of the $13.9 million. We required that the $2.6 million investment in a treatment facility at Plant F-10 be removed from

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[2] Section 790 provides:

> Whenever a water corporation sells any **real property** that was at any time, but is no longer, necessary or useful in the performance of the water corporation's duties to the public, the water corporation **shall** invest the net proceeds, if any, including interest at the rate that the Commission prescribes for memorandum accounts, from the sale in water system infrastructure, plant, facilities and properties that are necessary or useful in the performance of its duties to the public. . . (Pub. Util. Code § 790(a), emphasis added.)

rate base. In A.05-08-021, the ALJ is developing a complete record to allow us to determine what portion, if any, of the $13.9 million is rate base, and the flowthrough ratemaking impacts of modification of the rate base amount. We have again reviewed the record and find that D.04-07-034 was correct on this issue. Obviously, San Gabriel did not provide clear and convincing evidence that the $13.9 million or any portion of it should remain in rate base. That issue was left open and will be decided in A.05-08-021.

The City takes a different tack. It argues that San Gabriel has the burden of proof to show by clear and convincing evidence that a rate increase and any proposed expenses and projects are justified and is prohibited from deferring its showing on these issues to rebuttal. The City argues that in making its showing, the utility must "present an initial showing that sufficiently describes, explains and justifies the requested revenue requirement." (*Re San Diego Gas & Electric Company*, D.92-12-019, 46 CPUC2d 538, 555. In *San Diego Gas* the Commission said: "The Company often does not even mention the name of major programs or activities and almost never adequately explains its basis for forecasting related costs. The application often makes only a general request for funds without providing a reasonable, well-explained justification." Nor can the showing be deferred to rebuttal. The Commission declared:

> "SDG&E's guarded initial showing may be a product of a protective, litigative instinct. All too often, utilities offer only the minimal support for their rate requests, choosing instead to wait to see what subjects appear to be of interest to DRA. In response to DRA's concerns, utilities then provide focused rebuttal. This strategy may be traditional, but it is not acceptable." (46 CPUC2d at 764.)

After reviewing San Gabriel's initial showing,[3] the City concludes:

> "In short, the Company's initial showing is no showing at all. It does not describe the proposed capital projects and offers no justification for them. This showing is devoid of any justifications for a massive capital budget, specific projects, specific expenses, or the proposed rate increase. Because this initial showing fails, the Company's request for a rate increase necessarily fails." (City OB, p. 13.)

The City requests that the entire rate increase be refunded to the ratepayers. We will not grant this request.

In July 2002, San Gabriel submitted its NOI for a Test Year 2003 GRC for its Fontana Division in accordance with the rate case plan (RCP) in effect at the time. In October 2002, DRA acknowledged that San Gabriel's application was consistent with the requirements of the Commission's RCP, and instructed Docket Office to accept it for filing.[4] DRA's report evaluating San Gabriel's application was submitted at the end of July 2003. Partly in response to DRA's report and partly to reflect changes that had occurred in the year since its NOI had been submitted, San Gabriel served comprehensive updated rebuttal testimony in August 2003. During the four weeks of evidentiary hearings in September and October 2003, DRA and the City moved to strike portions of San

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[3] We have not set forth San Gabriel's initial showing in the decision because our view of the burden of proof issue in regard to this GRC goes beyond the applicant's initial showing.

[4] The Notice of Intent procedure is not simple. A company submits its NOI which is not filed until DRA authorizes the filing. In this case San Gabriel submitted its NOI in July 2002, which was not filed. In October, after much discovery and approval by DRA, the NOI was filed. (See formal file NOI 02-10-019.) San Gabriel submitted its GRC application on October 11, 2002, which was filed November 25, 2002 as A.02-11-044.

Gabriel's updated and rebuttal testimony as improper. The presiding ALJ denied the motions.

San Gabriel's Test Year 2003 GRC did not occur in a procedural vacuum. The NOI and then the application were processed in the context of the Class A Water Utility RCP decision that was adopted by the Commission in 1990.[5] The RCP sets forth the documentation a water utility must present at the time it files its NOI. If the utility fails to comply with the various requirements of the RCP order the NOI will not be accepted for filing and any deficiencies must be corrected within ten days. But, as noted above, DRA determined that both San Gabriel's NOI and its application were complete and they were accepted for filing.

In June 2004, a new RCP decision (D.04-06-018) made clear that water utilities would be required to bear their burden of proof to justify higher rates by making a stronger initial showing, but also that this was a new requirement different from the process previously applied. The introductory summary of that decision stated:

> We adopt two major process changes designed to ensure that we complete the [rate case] process within the designated review period. First, we require water utilities to provide all necessary information at the initial stage of the proceeding, rather than over a several month period. Second, we adopt a simplified, inflation-based escalation methodology for two years of the three-year cycle.[6]

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[5] *Re Schedule for Processing Rate Case Applications by Water Utilities* (1990), D.90-08-045, 37 PUC2d 175.

[6] *Rulemaking to Evaluate Existing Practices and Policies for Processing General Rate Cases and to Revise the General Rate Case Plan for Class A Water Companies*, D.04-06-018, *mimeo*. at 2.

To say that a rate case applicant's initial showing must provide clear and convincing evidence to meet its burden of proof does not encompass all the permutations of a complex rate case. DRA has the opportunity and the duty to carefully review the company's filing and challenge when appropriate. Certainly, the applicant must be given the opportunity to refute the challenge. Similarly, protestants and interested parties have standing to challenge and be challenged. A rate case does not fail because the applicant has not provided clear and convincing evidence on all issues; if it fails, it fails on individual issues.[7] In this application DRA's report was submitted in July 2003 with San Gabriel's rebuttal submitted August 2003; approximately 120 exhibits were received and ten days of hearings were held. The proceeding commenced with an NOI submitted in July 2002, and was decided in July of 2004. To reverse a decision two years in the making and refund two years of revenue increase because a utility failed to make its case solely on its initial showing would be an abrogation of our duty to provide a fair hearing and render a prompt decision, always considering the public need for a financially stable utility providing adequate service.[8]

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[7] The parties challenging D.04-07-034 rely on the SDG&E settlement case (46 CPUC2d 538) language that emphasizes the utility's need for a strong initial showing. What the parties did not include was the modifying language. "Because an all-party settlement obviates the need for the development (through hearings) of an extensive evidentiary record, the quality of the utility's initial showing becomes all the more important." (Id. at 764.) In D.04-07-034 we have "an extensive evidentiary record."

[8] We are mindful of our recently developed Water Action Plan (November 2005) which describes our objectives to maintain the highest standards of water quality and promote water infrastructure investment.

2. Are San Gabriel's proposed construction projects, including any changes or substitutions, needed, reasonable, and justified?

In D.04-07-034, we approved of all the items on San Gabriel's list of proposed construction (Exhibit 54) and we permitted San Gabriel to change or substitute any or all of them. However, in granting rehearing we said we did not know:

> "which, if any, of the items listed in Exhibit 54 will be constructed. Therefore, by finding that all of the items listed in Exhibit 54, as well as any unknown 'changes and substitutions' to Exhibit 54 are just and reasonable, provided they do not exceed the 10% rate cap, D.04-07-034 'pre-approves' unknown projects. This undermines Finding of Fact 8[9] by casting doubt on whether the plant additions ultimately constructed are 'needed,' since we did not know at the time D.04-07-034 was issued what the substitutions or changes may consist of. For these reasons we erred in concluding that the proposed construction is justified as required by sections 454 and 451." (D.05-08-041, p. 10.)

We have again reviewed San Gabriel's proposed construction project for test year 2004 to determine if it, or any part of it, was "needed, reasonable, and justified."

We start our inquiry with the oft-repeated standard:

> The purpose of a general rate case is to develop and adopt sound, informed estimates of the reasonable costs to be incurred in the test year. We know that our adopted levels of revenues and expenses may be at variance with actual experience. However, we must be

[9] Finding of Fact 8 provides that "San Gabriel has justified its proposed construction program including plans for needed plant additions that would increase its rate base at a rate of 10% per year." (D.04-07-034 at 65, Finding of Fact 8.)

> sufficiently informed to know that adopting a given estimate makes sense.

(Re San Diego Gas & Electric Company D.92-12-019, 46 CPUC2d 538, 555; Re PG&E D.00-02-046, p. 64; *See*, Re California-American Water Company D.02-07-011, pp. 6-7.)

There is nothing new or unusual about the Commission permitting a utility to change projects in a capital budget. Nor does uncertainty as to which projects will be constructed imply a finding that those projects are just and reasonable or pre-approved. Approval of San Gabriel's construction program and adoption of San Gabriel's list of plant addition priorities (Exhibit 54) facilitated the calculation of rate base for rate setting purposes, but they did not represent a guarantee of San Gabriel's future return on or recovery of its investment in any particular construction project.

Our ratemaking process for water utilities was reviewed in a recent GRC decision for California-American Water Company (Cal-Am):

> The recovery of expenditures through rates for water utilities is based on future test year rate of return ratemaking. [Footnote omitted.] This means that rates of Cal-Am are based on estimated rate base and expenditures for a future year. Actual rate base and expenditures can and do change between the time rates are set and the time events occur.
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> There is no requirement of the utility to spend exactly, or only, the projected amount on each rate base or expenditure component used to set rates. . . .
>
> We leave the fine-tuning of a utility's operation to the discretion of its management. Management discretion is exercised in allocating total dollars for capital and expense items to those areas where the capital and expense is most necessary, as dictated by constantly evolving priorities. . . . (D.02-07-011, at pp. 6-7.)

The forecasting of plant additions is part of the effort that must be made in any GRC to calculate the revenue requirement for a future test year. As San Gabriel explains, inclusion of Project X in a test year plant forecast and adoption of that forecast in a GRC decision does not guarantee that all investment in Project X will be deemed prudent and reasonable for inclusion in future GRC rate base calculations. In the next GRC, DRA may question whether the utility spent too much on Project X or that Project X was not or is no longer necessary or useful for utility service. The Commission may or may not agree, and may or may not exclude some or all of the Project X investment from rate base.

DRA asserts that the record is bare and insufficient, and does not support a finding that the company's ambitious construction was needed and reasonable. San Gabriel's proposed construction program (summarized in Exhibit 54) includes building seven new water production wells, seven booster pumping stations, six new reservoirs, related piping and equipment, and adding the necessary personnel to operate those wells and equipment. In addition, San Gabriel proposes constructing seven perchlorate wellhead treatment facilities at seven contaminated wells and building a new surface water treatment facility that would provide an additional 15 million gallons per day at site F-52. According to DRA, none of those projects was needed, and the record can only sustain a finding that none are needed.

The District contends that San Gabriel's proposed construction projects are not justified as the company has enough capacity to meet expected demand. The District points out that in January 2002 the California Department of Health Services (DHS) issued its annual inspection report for San Gabriel (Exhibit 73), which analyzed San Gabriel's customer demand and supply capacity. The report shows the 2001 average daily water usage for all customers at 38 million gallons

a day (mgd) and the maximum daily water usage at 60.9 mgd; total water production of San Gabriel, excluding wells out of service due to pollution or otherwise, measured 93.5 mgd. The report concluded San Gabriel's source capacity exceeded customer demand.

The District says that since January 2002 San Gabriel has added five wells to its system, creating 17.1 mgd of new production capacity. This new capacity, when added to the State's reported capacity of 93.5 mgd, gives San Gabriel a total production capacity of 110.6 mgd, while peak demand remains at 60.9 mgd. As a result, San Gabriel's production capacity approaches two times the peak demand and three times the average daily demand. Finally, San Gabriel's Urban Water Management Plan (UWMP) (Exh. 72) of December 2000, admitted the company possessed a sufficient supply, stating:

> Sufficient water supply and system capacity are available to produce two to three times current production quantities. (At p. 2.)

The District argues that the DHS evidence and San Gabriel's own Urban Water Management Plan support only one conclusion: San Gabriel produces more than enough capacity to service customer demand and requires no new production capacity.

San Gabriel says the findings in the January 2002 DHS report that total capacity for the Fontana Division was 93.5 mgd, with maximum day demand of 60.9 mgd, are substantially out of date. Further, to the extent they are useful, the broad statements in the 2000 UWMP are consistent with the testimony and evidence San Gabriel provided in this proceeding. San Gabriel agrees there is ample water supply available to be pumped from the Chino Basin and, when climatic conditions permit, from Lytle Creek, subject to the existing surface water treatment limitations, and that capacity exists to deliver such supplies to

customers. The problem, San Gabriel asserts, is that facilities to tap that supply may not be adequate under circumstances of customer growth, expanding contamination, and extended drought. San Gabriel says it needs to make investments to ensure that it does not become subject to future supply deficiencies and remains able to provide reliable service to existing and new customers. The 2000 UWMP statement that San Gabriel does not plan to develop new source capacity to meet projected demand, has been outdated by continued groundwater contamination, changing regulatory standards, and worsening drought.

San Gabriel explains that Exhibit 73 is not its exhibit, but rather a DHS inspection report, placed on record without a DHS representative to sponsor it. Its 2001 showing of total capacity for the Fontana Division of 93.5 mgd in contrast to maximum day demand of 60.9 mgd, is obsolete and misleading in relation to the (2003) evidence of record in this proceeding. San Gabriel asserts that considering the unavailability of seven perchlorate-contaminated wells, it is clear that the capacity shown in Exhibit 73 for Wells F-04A, F-17B, F-17C, F-18A, F-25A, F-31A, and F-35A should be deducted from the total, as should the capacity of Well F-10A, shown by Exhibit 73 as not in service. Deducting these wells' total capacity leaves total well capacity of 59.3 mgd reliably available in 2001. This would have been insufficient to meet maximum peak day demand (60.9 mgd in 2001, 62.4 mgd in 2002).

San Gabriel observes that the District's analysis of San Gabriel's production capacity needs is grossly oversimplistic. San Gabriel states that the presence of nitrate contamination in the Chino Basin complicates its use of that resource, but the major problem with use of Chino Basin wells is perchlorate, which has contaminated seven of its wells. The fact that two of those wells

previously had been removed from service due to nitrate contamination did not render the wells any more available for use during 2003 or thereafter. San Gabriel lost the use of seven wells and their 21.5 mgd of production capacity. Those wells could not be returned to regular use until wellhead treatment for perchlorate contamination (and in some cases nitrates) was installed. San Gabriel developed Exhibit 74 to present a more current account of the production capacity actually available to San Gabriel during the summer of 2003. Exhibit 74 shows the source of the 56.3 mgd of uncontaminated well capacity available to San Gabriel during the summer of the drought year 2003. Given the lack of a knowledgeable witness to interpret the significance of the information in Exhibit 73, given the more timely and more relevant information provided by Exhibit 74, San Gabriel argues that Exhibit 73 should be accorded no weight.

We have independently reviewed the testimony of San Gabriel's witnesses regarding needed construction and find that D.04-07-034 Finding of Fact 8 was correct.[10]

Consulting engineer Wildermuth testified for San Gabriel about the hydrology and reliability of available surface water and groundwater sources

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[10] Ordering Paragraph 3 of D.04-07-034 states: "3. Commission review of the reasonableness of San Gabriel's investment in the proposed new office building should be deferred to the next GRC proceeding. However, San Gabriel should be authorized to purchase land for such a building and include the cost in ratebase subject to the ratebase cap."

San Gabriel did not present clear and convincing evidence of the reasonableness of the purchase price of the land for the new office building, nor is the record clear as to how much of the purchase price, if any, was included in rate base. We will review this issue in A.05-08-021.

and about water rights and water quality problems affecting those sources of supply. His key conclusions were:

> The water demands of Fontana Water Company customers are increasing steadily and Fontana Water Company must make investments to increase its water production to reliably meet these demands. Some of Fontana Water Company sources have become increasingly contaminated due to historical land uses and from the continual listing of new contaminants and improvements in laboratory detection limits. (Exh. 14, p. 1.)

He based his conclusions on (among other reasons):

1. The Chino Basin is the only one of Fontana Division's water sources that remains reliably available during drought periods and he noted that Fontana Division was increasingly dependent on that source;

2. The Fontana Division will need to make significant improvements to its water system, including construction of new wells and groundwater treatment systems to remove various contaminants, to increase its Chino Basin production capacity sufficiently to meet peak summer demand;

3. There are significant groundwater quality problems affecting the Rialto-Colton and Chino Basins, with an increasing presence of nitrate and perchlorate and the high concentrations of arsenic and volatile organic compounds; and

4. The perchlorate plume currently affects a number of Fontana Division wells.

San Gabriel's Vice President – Engineering and Operations testified that the projected 43% increase in average plant over a three-year forecast period would provide for construction of seven water production wells, seven booster pumping systems, six water storage reservoirs, and related piping and other equipment, as well as construction of wellhead treatment facilities at seven perchlorate-contaminated wells, construction of the first 15 million-gallon-per-

day increment of a new surface water treatment, and construction of a new office, garage, and warehouse.

In our opinion, the DHS inspection report (Exh. 73) has been superseded by time and events. It was based on an analysis two years old by the time of the hearing and could not have predicted the increase in contaminants and their deleterious effect on well availability in the intervening years. San Gabriel's evidence on those issues was the most current and most accurate. We find it clear and convincing.

To determine if the 10% increase per test year found reasonable in D.04-07-034 was in fact "needed, reasonable and justified" we look at historical service connections, water usage, and rate base. San Gabriel's service connections for the recorded period 1998-2002 increased, on average, over 1,300 per year. DRA estimated that San Gabriel would expect an increase of 1,410 connections in 2003 and 1,336 connections in 2004. Historical water usage for an average residential customer was estimated at 321 Ccf/year. DRA estimated an increase to 336.5 Ccf/year. (See DRA Exh. 17.)

A Comparison of Average Rate Base with
Average Number of Customers for
Recorded Years 1997-2002 Shows (Exh. 58):

Year	**Average Rate Base**	**Increase Over Prior Year**	
1997	$37,100,400		
1998	40,951,500	$3,851,100	10.4%
1999	44,462,400	3,510,900	8.6%
2000	49,574,600	5,112,200	11.5%
2001	55,176,400	5,601,800	11.3%
2002	59,609,400	4,433,000	8.0%
Five-Year Average			10.0%

Year	Average No. of Customers	Increase Over Prior Year
1997	31,137	
1998	32,219	1,082
1999	33,756	1,537
2000	35,334	1,578
2001	36,633	1,299
2002	37,914	1,281
Five-Year Average		1,355

With DRA forecasting increased customers in 2003 and 2004, in line with five years of recorded numbers, we would be remiss in our duty to assure adequate service should we fail to provide for growth. Our review of the record shows clearly and convincingly that a 10% rate base cap was needed, reasonable, and justified. As we have already noted, we weighed the evidence on this subject in D.04-07-034 and have re-weighed it in this rehearing. We are not persuaded to modify D.04-07-034 on its construction budget findings. We need not authorize specific projects. The construction budget, and rate base, will get a third review in the current GRC, A.05-08-021. In that third review, we will have the opportunity to determine the reasonableness of what actually has been constructed since 2002. To the extent that construction was unneeded, it will be found to be unjustified and therefore unreasonable. Because current rates are subject to refund, any finding in A.05-08-021 will have the same effect and finding in this rehearing. The difference is palpable: rather than forecasting that a project is or is not necessary, we have the benefit of hindsight to review whether the project was, in fact, needed. This is the lesson of all rate cases which are based on a forecast year.

3. Is there evidence of record supporting the finding that $2.6 million in proceeds received from the County of San Bernardino were invested in Plant F-10 and whether proceeds invested in Plant F-10 should also be subject to the audit ordered by D.04-07-034 in order to determine precisely what amount was invested in Plant F-10 Plant and should be removed from ratebase?

The evidence of record supports the finding that $2.6 million in proceeds received from the County of San Bernardino were invested in Plant F-10. Exhibit 90, introduced by DRA, shows that $2.6 million was invested in the plant. (See, also, Exh. 94.) Exhibit 24, introduced by DRA, is a settlement agreement between San Gabriel and the County of San Bernardino whereby the County paid about $8.6 million to San Gabriel to compensate for ground water contamination.

The proceeds San Gabriel received from the County and the investments San Gabriel made in well-head treatment facilities at Plant F-10 are the consequences of volatile organic compound contamination that originated in the County's Mid-Valley Landfill and compelled San Gabriel to remove certain wells from utility service. San Gabriel asserted claims for inverse condemnation and damages against the County. The County entered into an $8.6 million settlement of San Gabriel's claims which provided for compensation to San Gabriel for contamination damage, and for San Gabriel to construct and operate a groundwater treatment facility at its Plant F-10 to be operated in a fashion that would allow the County to comply with the Regional Water Quality Control Board's clean-up and abatement orders.

The evidence does not show that the dollars from the County are the same dollars that paid for Plant F-10 investment, but that is irrelevant. Money is fungible. San Gabriel received money to be spent on Plant F-10 and it is clear

that San Gabriel spent at least $2.6 million on the plant. The $2.6 million was considered a contribution in aid of construction and removed from rate base. It is not clear whether more was spent. Exhibit 94 shows that during this time period at least an additional $830,000 was spent on improvements to Plant F-10 which was not removed from rate base. Exhibit 94 may or may not be accurate; the record is unclear, therefore the subject warrants further study in San Gabriel's current general rate case for its Fontana Division, A.05-08-021. The proceeds invested in Plant F-10 should be subject to the audit ordered by D.04-07-034.[11]

4. **Are there special circumstances warranting San Gabriel's deviation from SP U-16, concerning working cash?**

SP U-16 is a lengthy, detailed report which serves as a guide to the Commission staff in preparing a working cash allowance. It defines working cash:

> " 5. The working cash allowance is a component of rate base. It can be positive or negative. Its purpose is to compensate investors for funds provided by them which are permanently committed to the business for the purpose of paying operating expenses in advance of receipt of offsetting revenues from its customers and in order to maintain minimum bank balances. Cash held for construction, for purchases of stock, for payment of dividends and interest on funded debt, and like purposes does not qualify for inclusion in cash working capital."

• • •

[11] The audit does cover Plant F-10. The audit will be considered in A.05-08-021.

> " 8. …The regulatory concept, on the other hand, defines working capital as an allowance for the amount of money which the utility has furnished from its own funds for the purpose of enabling it to satisfy ordinary requirements for minimum bank balances and to bridge the gap between the time expenses of rendering utility service are paid and the time revenues from the same service are collected."

In re *Pacific Gas and Electric Company* we held that the guidelines of SP U-16 "… are not rules which the utilities must follow. They are, however, rules that we will follow in developing rates unless the utility can demonstrate special circumstances which warrant a deviation. (D.94-02-042.)" (In re *Pacific Gas and Electric Company,* 63 Cal.P.U.C.2d at 617, emphasis added.) DRA argues that San Gabriel should either have followed SP U-16 or demonstrated a special circumstance necessitating its deviation from that requirement.

San Gabriel's requested working cash allowance was $631.2 thousand in 2003 and $739.1 thousand in 2004 (Exh. 2, p. 10-7); DRA's estimates were minus $20.99 million and minus $21.85 million, respectively (Exh. 17). In D.04-07-034, we adopted a working cash allowance of $477.1 thousand in 2003 and $645.7 thousand in 2004.[12]

DRA argues that San Gabriel should have deducted from working cash the following U-16 items:

(a) Customer Deposits – non-interest bearing;

(b) Insurance Reserves;

(c) Deferred Credits;

[12] We use the terms "requested" and "adopted" quite literally. Unlike other cost items in a GRC, there is no recorded amount for a working cash allowance.

(d) Accrued Vacation and Sick Leave;

(e) Amounts Withheld from Employees;

(f) Taxes Accrued; and

(g) Accounts Payable.

DRA observes that if these amounts are not excluded, the investors in effect would be compensated for funds they have not supplied. San Gabriel failed to reduce its working cash in accordance with U-16 for certain accrued expenses, other liabilities, and funds provided by customers, or funds not provided by the shareholders. San Gabriel's failure to make adjustments to its working cash estimate in accordance with SP U-16 resulted in overstatement of its rate base.

DRA claims that San Gabriel did not demonstrate special circumstances justifying deviation from U-16. San Gabriel's deviation from the Commission's accepted method of computing working cash results in millions of dollars improperly being included in rate base and, consequently, higher rates for San Gabriel's ratepayers. DRA recommends that the Commission order San Gabriel to submit a correct calculation of working cash in accordance with SP U-16, and submit it for review prior to being accepted in its current GRC. DRA contends, it is not staff's obligation to correctly calculate working cash – it is the company's burden in submitting an application to include correct calculations.

SP U-16 does not mandate a single methodology for calculating working cash. Rather, it "serves as a guide to the staff engineer or analyst" (not the utility) based on current staff practices that the engineer or analyst should consider in determining the working cash allowance. (SP ¶ 1.)

There are two main elements to the calculation of a working cash allowance: a lead-lag study and an operational cash requirement. The lead-lag

methodology employed by San Gabriel is addressed in the Detailed Basis method in SP U-16 (at Paragraphs 29 through 48). DRA made no claim that San Gabriel's lead-lag study did not comply with SP U-16 or that it erred in calculating lead or lag days.

It was in the calculation of the Operational Cash Requirement that issues were presented. In U-16, Chapter 1, Working Cash Allowance – Detailed Basis, of the SP, Section B – Determination of Operational Cash Requirements identifies six operational cash requirements for working cash: Cash, Special Deposits, Working Funds, Notes Receivable, Prepayments, and Other Defined Debits. San Gabriel's responses to DRA's Master Data Request identified these cash requirements for working cash as totaling $4,071,000 for the Fontana Division. Section C then provides for "Deductions from the Operational Cash Requirement." San Gabriel's response to the Master Data Request identified the deductions from the operational cash requirement as totaling $3,878,000. Applying this method yields an Operational Cash Requirement of $193,000 ($4,071,000 less $3,878,000). That would have been the amount consistent with SP U-16, to have combined with the results of San Gabriel's lead-lag study.

DRA, however, reported that while it accepted the amounts San Gabriel showed from its lead-lag study, DRA adjusted these amounts for the deductions that are required by U-16. In other words, DRA took account of the $3,878,000 in deductions from the operational cash requirement but ignored the $4,071,000 in operational cash requirement from which those deductions should have been taken.

In its calculation of the Operational Cash Requirement, San Gabriel used the minimal cash balances required to be maintained in its customer service office cash drawers, petty cash, minimal balances in its regular checking and

return checking bank accounts, and one-half of its postage account maintained at the post office. The total of these items was $26,000.

San Gabriel says that DRA calculated the working cash allowance, in conflict with SP U-16, by including items that reduce working cash (Deductions from Operational Cash Requirement) while ignoring related items that increase the working cash allowance (Operational Cash Requirement) and by deducting from the working cash allowance proceeds from surplus property sales and involuntary conversions that are beyond the scope of SP U-16.

San Gabriel's witness Batt testified that he did not follow U-16 entirely, but used a comparable method that San Gabriel had used in prior rate cases which the Commission had adopted. San Gabriel argues that DRA's gross violation of both the intent and the procedures of SP U-16 – in contrast to San Gabriel's approach, which benefited ratepayers –presents sufficient "special circumstances" to justify the D.04-07-034 determination that San Gabriel's estimate of working cash should be adopted.

We have again reviewed the exhibits presented by the parties on working cash (San Gabriel – Exh. 1, 2 and 8; DRA – Exh. 17) and the testimony of the witnesses on the subject. SP U-16 does not mandate that the utility follow its method, nor does it mandate that the Commission staff follow it. It is a guide – it "serves as a guide to the staff engineer or analyst" (SP ¶ 1) who in the final analysis must use best judgment (SP ¶ 8).[13] It is not binding on the staff, and

[13] In the final analysis the amount of working cash to be included in the rate base must rest upon the engineer's judgment. The amount of working cash allowance in the end result is essentially a judgment amount based upon what the staff engineer believes to be fair and reasonable for the operations of the utility but within limitations dictated by the size of the utility and staff policy. (SP ¶ 8, emphasis in original.)

certainly not on the utility, but it is preferred. In considering the record in this application we find DRA's analysis of the Operational Cash Requirement of working cash to be in error. DRA accounted for deductions from the requirement but failed to account for the actual cash requirement. On this record we find the working cash estimate of San Gabriel is reasonable and should be adopted. To the extent that special circumstances support that estimate we find that San Gabriel's estimate followed its past practices in GRCs, which had never been criticized. Our conclusion to adopt San Gabriel's working cash allowance is buttressed by DRA's Exhibit 17. DRA's negative operational cash requirement is a separate line item on its rate base analysis, as is its working cash estimate. When the operational cost deduction is eliminated the remaining DRA working cash allowance is exactly the same as San Gabriel's. (Exh. 17, Table L-1 (2003) and L-2 (2004).[14]

Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Section 311(g)(1) of the Public Utilities Code and Rule 77.7 of the Rules of Practice and Procedure.

Comments were filed by San Gabriel, DRA, the City, and the District. San Gabriel pointed out some minor errors, which have been corrected. DRA says it was unaware that a review of post-2002 projects covered under the 10% rate base cap was included in A.05-08-021. It seeks to reserve its right to be able

[14] All this discussion begs the question of why such a qualitative assessment is transformed into a rigorous (and time consuming) quantitative calculation. The deeper one looks, the more U-16 appears to be a Gilbert & Sullivan operetta (unreal and highly imaginative). Perhaps the time has come to reconsider the efficacy of U-16 itself.

to review those projects.[15] Issues regarding rate base are always subject to being raised in a general rate case. When a party suspects a plant in rate base is not used and useful, or is not accurately recorded on the company's books, those issues should be raised as early as possible. Rate base issues were left open in D.04-07-034 to be resolved in A.05-08-021. We are reviewing D.04-07-034 based solely on its record. We are not reviewing A.05-08-021 and the issues raised, or which might be raised, in that proceeding. DRA's request is premature and, therefore, denied.

The City recommends that the proposed order in the draft decision should be modified because it is currently limited to a refund to the extent these funds were included in rate base. The City says, to the extent that any such monies were not put in rate base but were otherwise retained by San Gabriel or its shareholders, refunds still should be required. The order also does not reflect the amount of refunds or the time, place and method of how the refunds are to be calculated and effectuated. The City recommends that the proposed order indicate that such refunds are to be either determined in the current rate proceeding or the current OII (I.06-03-001). The issues the City raises are issues for A.05-08-026 and the OII. This decision on rehearing only deals with the issues raised in the decision granting rehearing.

Other issues raised by the parties merely re-argue matters previously raised in their briefs, and will be disregarded.

[15] The City and District make the same request.

Assignment of Proceeding

John A. Bohn is the Assigned Commissioner and Robert Barnett is the assigned ALJ in this proceeding.

Findings of Fact

1. The Findings of Fact, Conclusions of Law, and Ordering Paragraphs of D.04-07-034 are affirmed.

2. San Gabriel has met its burden of proof on all issues except certain ratemaking issues: (A) gains from (1) sales of real estate, (2) water contamination lawsuits and settlements, (3) condemnations, and (4) inverse condemnations; (B) contributions in aid of construction; and (C) the purchase price of land for a new office.

3. San Gabriel's proposed construction projects, including any changes or substitutions, are needed, reasonable, and justified to the extent that they do not exceed the 10% rate cap imposed by D.04-07-034.

4. There is evidence of record supporting the finding that $2.6 million in proceeds received from the County of San Bernardino were invested in Plant F-10.

5. Investment in Plant F-10 should be subject to the audit proceeds ordered by D.04-07-034.

6. There are special circumstances warranting San Gabriel's deviation from SP U-16, concerning working cash. San Gabriel did not follow U-16 entirely, but used a comparable method that it had used in prior rate cases which the Commission had adopted.

Conclusions of Law

1. D.04-07-034 is affirmed.

2. The Ordering Paragraphs of D.04-07-034 should be clarified by Ordering Paragraph 1 of this decision.

O R D E R

IT IS ORDERED that:

1. The rates and charges authorized by Decision 04-07-034 are subject to refund to the extent that they are based upon a rate base which includes plant purchased with funds received from: (A) gains from (1) sales of real estate, (2) water contamination lawsuits and settlements, (3) condemnations, and (4) inverse condemnations; (B) contributions in aid of construction (CIAC); and (C) the purchase of land for a new office. To the extent that financial gains were not the property of San Gabriel (and should have been allocated to ratepayers), but were invested in plant, those gains should be treated as CIAC.
2. Application 02-11-044 is closed.

This order is effective today.

Dated June 15, 2006, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners